No. 15,321

United States Court of Appeals

For the Ninth Circuit

JOHN COSTELLO, as Trustee of the Estate of William Jason Evans, Bankrupt, *Appellant,*

vs.

BANK OF AMERICA NATIONAL TRUST & SAVINGS ASSOCIATION, a corporation, *Appellee.*

APPELLANT'S OPENING BRIEF.

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APPELLANT'S OPENING BRIEF.

STATEMENT OF JURISDICTION.

Appellant filed a complaint in the United States District Court for the Northern District of California, Southern Division (Tr. p. 3) to set aside a transfer of accounts receivable pursuant to the provisions of Section 70e of the Bankruptcy Act (11 U.S.C.A. 110e). The District Court rendered its judgment in favor of appellee (Tr. p. 48) (141 F. Supp. 225). Pursuant to the provisions of 11 U.S.C.A. 47, appellant filed his notice of appeal on August 16, 1956 (Tr. p. 50), which notice of appeal was timely filed (11 U.S.C.A. 48).

STATEMENT OF QUESTION PRESENTED.

Where accounts receivable, assignment of which was void for failure to comply with the provisions of Section 3019 of the Civil Code of the State of California, have been collected by the assignee thereof more than four months prior to the bankruptcy of the assignor, may the trustee of the assignor's bankrupt estate, pursuant to Section 70e of the Bankruptcy Act, recover from the assignee the amounts collected from the assignee under such void assignment?

STATEMENT OF FACTS.

On September 15, 1948, the bankrupt entered into a contract with the State of California to perform work and services and to supply materials in the construction of a public work known as the Chamberlain Creek job (Tr. p. 75; Plaintiff's Ex. 1). The contract was assigned to appellee on the same day (Plaintiff's Ex-4). There was no notice of intention to assign accounts receivable filed, as required by Section 3019 of the California Civil Code. At the time of the assignment, the bankrupt had certain creditors who were still creditors at the time of the filing of the original petition in bankruptcy. These facts were so found in support of appellant (Findings No. 3 and 4, Tr. p. 43; Finding No. 6, Tr. p. 44; Finding No. 13, Tr. p. 46).

The trial court found that the indebtedness from the State of California to the bankrupt was an "account" within the meaning of Section 3017 of the California

Civil Code (Finding No. 7, Tr. pp. 44-45), and that the loans and advances made by appellee to the bankrupt and which were secured by the assignment of the "account" in question were repaid to appellee from the proceeds of the said assigned contract between bankrupt and the State of California (Finding No. 11, Tr. p. 45).

ARGUMENT.

THE DISTRICT COURT ERRED IN HOLDING THAT APPELLANT COULD NOT RECOVER BECAUSE THE ACCOUNT HAD BEEN EXTINGUISHED BY PAYMENT.

See 4 *Collier on Bankruptcy,* 14th Ed., Section 70.71 page 1348, where it is stated:

> "It is well settled that under Section 70e(1) any transfer, lien, encumbrance, obligation or other transaction affecting the bankrupt's property, fraudulent as to a creditor under the applicable state (or federal) law, may be avoided by the Trustee in Bankruptcy. This is made doubly clear and reinforced by the terms of Section 70a(4)" (Citing cases).

The Trustee in Bankruptcy, under Section 70a(4) of the Bankruptcy Act (11 U.S.C.A. 110a(4)) is vested by operation of law with the title of the bankrupt to . . . "property transferred by him in fraud of his creditors", and (5) to property "including rights of action which prior to the filing of the petition he could by any means have transferred . . .". If the assignment in question is invalid, void or voidable as to any creditor under the state law to be hereafter

discussed, it is recoverable by the trustee under Section 70e (11 U.S.C.A. 110e) of the Bankruptcy Act, which reads, in part, as follows:

> "Section 70. *Title to Property.*
>
> e.(1) A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor."

The court found that the assignment of accounts receivable herein in question was an account within the meaning of Section 3017 of the Civil Code of the State of California (Finding No. 7, Tr. p. 45 and Conclusion No. 1, Tr. p. 47), which then read as follows:

> "Section 3017. (Definitions). In this chapter
>
> (1) "'*Account*' means an open book account, mutual account, or account stated, due or to become due, carried in the regular course of business and not represented by a judgment, note, draft, acceptance, or other instrument for the payment of money; it includes rights under an unperformed contract for work, goods or services which in the regular course will result in an open book account.
>
> (2) "'*Assignment*' shall include any transfer, pledge, mortgage or sale.
>
> (3) "'*Creditor*' means a person having any claim, whether matured or unmatured, liquidated or unliquited, absolute, fixed or contingent.

(4) "'*Debt*' means the indebtedness owing to an account.

(5) "'*Debtor*' means any person by whom an account is owing to the assignor.

(6) "'*Filing officer*' means that county recorder of the county in which the assignor has its principal place of business within this State, or if the assignor has no place of business within this State then the county recorder of the county in which the assignor resides."

and that there was no notice of intention to assign or notice of assignment as required by the then provisions of Section 3019 of the Civil Code of the State of California which then read as follows:

"*Requisites of assignment and notice.* No assignment of an account shall be valid as against present or future creditors of the assignor without notice of such assignment or as against a subsequent purchaser or assignee of such account without notice of such assignment:

. . . Unless there shall be on file in the office of the filing officer, at the time of the execution of such assignment, or prior to the time when credit is extended to the assignor or prior to the time when a subsequent assignment is made, as the case may be, a presently effective and uncanceled notice signed by the assignor and the assignee, containing:

A designation of the assignor and the assignee, and of the chief place of business of each within this State, if any, and if either of them has no place of business within the State, a designation of his residence or chief place of business outside the State and a designation of the general nature

of the business out of which such accounts arise; and, either

(a) A statement that the assignor expects to assign or has assigned an account or accounts then existing or thereafter arising to the assignee, or

(b) A statement that the assignor expects to assign or has assigned, certain specified accounts in which event the statement may contain:

(1) A list of the accounts so to be assigned, setting forth the amount of each account and the names and addresses of the persons owing the same; and

(2) If such accounts are to be assigned, as collateral security for a specific obligation, a declaration to that effect, and a statement of the amount of such obligation."

Appellant agrees with all of the findings made by the trial court, and appellee has taken no appeal from any of these findings and conclusions, and therefore the sole question before the court is whether the collection of the account by the assignee extinguished the accounts with the result that the Trustee in Bankruptcy has no cause of action under Section 70e (Conclusions Nos. 4 and 5, Tr. p. 47). *American Trading Co. v. Steele*, 274 F. 774.

The only other reported decision directly on this subject is the decision of Judge William Byrne of the United States District Court for the Southern District of California, in the case of *Menick v. Carson,* 96 F. Supp. 817, where the question was thoroughly analyzed and the court reached its decision in favor of appel-

lant's position. We quote from the decision as follows, commencing on page 819:

> ". . . *If, as the defendant claims, the plaintiff is limited merely to a right to set aside assignments of accounts that are outstanding or unpaid the very purpose of the statute would be defeated.* That purpose is to prevent secret liens and transfers which deceive a creditor who extends or continues credit on the basis of the debtor's financial position. If the debtor secretly assigns his accounts and a creditor extends credit in reliance on the possession of the debtor of the accounts, the creditor has been deluded and may set aside the assignments. *To say that the assignee may avoid this result by merely collecting the accounts is to present him with a device which would practically made the statute a nullity.*" (Italics ours.)

> "We think the proper construction of this statute is to make its protection available to all existing or 'present' creditors, i.e., those creditors who extend credit prior to the assignment of the accounts, and only to those 'future creditors' who extend credit after the assignment, but before recordation or collection of the account by the assignee."

> "The creditor who extends credit after the accounts have been collected has not been deceived, because proper investigation will disclose that there are no accounts. The creditor who extends credit subsequent to the unrecorded assignments, but prior to the extinction of the accounts through collection, may set aside the assignments and if the accounts are collected subsequent to the accrual of his right he may resort to the proceeds."

". . . such a construction preserves the purpose of the statute without distorting it into a weapon in the hands of creditors who have in no way been prejudiced by the assignment. Also it brings Section 3019 into complete harmony with Civil Code Secs. 2957 and 3440, and is consistent with the manifest policy of the law with regard to secret liens. (Citing *Ruggles v. Cannedy,* 127 Cal. 290, and *Palmer v. Howard,* 72 Cal. 293, 13 P. 858."

"Section 3019 is but one more link in a chain fashioned by the Legislature for the protection of creditors against the evils of secret liens and the secret disposal of assets to the detriment of those who presumably relied on the existence of these assets when they extended credit. In *Bank of America NT&SA, v. Sampsell,* 9 Cir. 114 F. 2d, 211, the Court noted that the California courts have construed Section 2957 in pari materia with Section 3440. Since Section 3019 deals with the same general subject and has the same purpose, it should be construed in pari materia with Sections 2957 and 3440."

"Section 3440 is aimed at protecting creditors against the secret disposal of personal property. For obvious reasons it expressly excepts choses in action which would include the type of accounts with which Section 3019 is concerned. In enacting Section 3019 to protect creditors from secret disposal of certain kinds of accounts, the Legislature seemingly chose this method because Section 3440, by its very nature, could apply only to tangible personalty. Section 3440 provides, in part, that 'every transfer of personal property, other than a thing in action. * * * is conclusively presumed if made by a person having at the time the possession or control of the property, and not

accompanied by an immediate delivery, * * * to be fraudulent and therefore void, against those who are his creditors while he remains in possession * * * and the successor * * *.' "

"*Thus we see that the California courts and the Federal courts applying California law have given Sections 2957 and 3440 a harmonious application in order to effectuate the single policy which underlies both. We are satisfied that Section 3019 is in paria materia with both of those sections, and must be given a similar construction.*" (Italics ours.)

Judge Bryne clearly shows that he treats the assignment of accounts receivable section as "secret lien" legislation, and that the District Court in the instant case so considered it is apparent from the reading of its opinion and order for judgment (Tr. pp. 27-42).

As we have pointed out, *Menick v. Carson* is the only reported decision directly in point. However, both this court and the Supreme Court of the State of California, in the cases to be hereafter discussed, have ruled on the Trustee in Bankruptcy's right to recover where there had been a seizure and sale by the mortgagee under a chattel mortgage void under the laws of the State of California. The law relative to chattel mortgages is also "secret lien" legislation and is completely analogous to the law involved in the case at bar, and is also authority for the Trustee's right to recover pursuant to the state law under Section 70e of the Bankruptcy Act. The Supreme Court of the United States has permitted the Trustee to recover in an action involving a fraudulent pledge as will be discussed below.

In *England v. Moore Equipment Co.,* 94 F. Supp. 532 (affirmed by this court, 185 F. 2d 1019), the court held that where a chattel mortgage was executed and was valid by compliance with the state law, but that thereafter the lien of the mortgage was lost by the removal of the personal property to another county for more than thirty days, and where the property was thereafter seized by the mortgagee and sold, that the Trustee in Bankruptcy could recover the proceeds of the sale. Although the trustee in that case proceeded under the preference section of the Bankruptcy Act, the language of the court is very plain that the mortgagee was nothing more than a general creditor by reason of the failure to comply with the Civil Code sections relating to chattel mortgages.

In *Noyes v. Bank of Italy,* 206 Cal. 266,[1] the Supreme Court of the State of California also followed the same rule with regard to an invalid chattel mortgage and stated as follows:

> "Even if it be assumed that a mortgage void as to creditors pursuant to the plain terms of the statute could be transformed into a valid mortgage by the mortgagee seizing the mortgaged property or by otherwise taking possession of the same with

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[1]Reversing *Noyes v. Bank of Italy* (District Court of Appeal), 259 Pacific 60, where the court, at page 63, said:

> "Appellant offered to prove that possession of the chattels, under the terms of the mortgage, was taken by the appellant bank, and after compliance with the Code relative to the sale of mortgaged chattels as a pledge, the chattels were sold, which taking, possession, and sale occurred sometime prior to the adjudication of Paul Petrich, a bankrupt, and the appointment of respondent as trustee; offered as evidence the chattel mortgage, containing the affidavit of the mortgagor and the mort-

the consent of the mortgagor and thus shut out general creditors or creditors not possessing a lien or armed with process, yet we are satisfied that it was the intention of the Bankruptcy Act to safeguard the rights of such general creditors by giving the trustee the status of a lien creditor and also to prevent the mortgagee from defeating the rights of the creditors of the bankrupt by contending that such creditors were general creditors only. It seems reasonable to conclude, also, that the purpose of the Bankruptcy Act in vesting power in the trustee to attack a chattel mortgage void under the statute was to render ineffectual as to creditors the act of the mortgagee in taking possession of the property before the commencement of the bankruptcy proceedings. In other words, the trustee was intended to be placed in the position of a lien creditor who would, but for the bankruptcy proceeding, be entitled to attack the alleged void mortgage and to enable him to protect the interests of general creditors against invalid liens, unlawful transfers, etc." (1 Collier on Bankruptcy, 12th Ed., p. 728 et seq.)

The Court of Appeals for the 6th Circuit reached the same conclusion in *Lemmen v. Timmer,* 89 Fed. 2d 1011, affirming 19 F. Supp. 687.

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gagee, that the mortgage was made in good faith and without design to hinder, delay, or defraud creditors, being devoid only of the acknowledgment, and that the mortgage was good as between the parties. This evidence under the objection of respondent was excluded from the record. These issues were not tried, and this judgment cannot stand until they have been tried and determined adversely to appellant's position. The judgment must be reversed, and upon a new trial permission should be granted defendant to establish, if it can, the validity of its mortgage between itself and the owner, and it is accordingly so ordered."

In another analogous situation, the Supreme Court of the United States upheld the Trustee in Bankruptcy's right to recover under Section 70e of the Bankruptcy Act in the case of *Buffum v. Peter Barceloux Company,* 289 U.S. 27, 77 L.Ed. 1140. In that case there was a pledge found to be fraudulent as to creditors, *and the Trustee was permitted to collect the value of the property transferred where the transferee had transferred the property to a third person.*

From the foregoing decisions with regard to the trustee's rights to recover the proceeds of transactions invalid by reason of the failure to comply with the secret lien legislation of the State of California, it seems apparent that the District Court was in error in refusing to permit the trustee to collect the proceeds of the void assignment, since by so doing the District Court permitted the appellee to obtain benefits pursuant to an invalid assignment contrary to the rulings of this court in *England v. Moore Equipment Co.,* supra, of the Supreme Court of the State of California in *Noyes v. Bank of Italy,* supra, and of the United States Supreme Court in *Buffum v. Peter Barceloux Company,* supra. To follow the District Court's theory we contend would be contrary to public policy generally and to the expressed legislative policy against "secret liens", because it obviously results in a race between the assignee under a void or voidable assignment and the institution of bankruptcy proceedings and/or actions by the trustee or creditor to avoid such assignments. It puts a premium on the diligent (though fraudulent) assignee at the expense of the creditors who because

of the noncompliance by such assignee with the provisions of Section 3019 of the Civil Code had no knowledge of the constructively fraudulent assignment. The reading of the provisions of Section 70e in conjunction with the provisions of Section 70a makes it clear that the laudable purposes of the Uniform Assignment of Accounts Receivable Act are substantially defeated by the strained construction which the District Court has placed upon the transaction in question.

CONCLUSION.

In view of the facts and law hereinabove set forth it is appellant's contention that the District Court erred in holding that the payment of the assigned account prior to the filing of the bankrupt's petition in bankruptcy extinguished the obligation, and that appellant had no cause of action under Section 70e of the Bankruptcy Act, and that therefore the judgment of the District Court, August 6, 1956, should be by this court reversed, with instructions to the lower court to enter judgment for appellant as prayed.

Dated, January 30, 1957.

Respectfully submitted,

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